No. 88-181

Supreme Court, U.S.
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In The
Supreme Court of the United States
October Term, 1988

Houston Lighting & Power Company,
Appellant,

vs.

Public Utility Commission of Texas,
Appellee.

On Appeal from the
Supreme Court of Texas

Motion to Dismiss or Affirm

Jim Mattox
Attorney General of Texas

Mary F. Keller
First Assistant Attorney General

Larry Laurent
Assistant Attorney General
Chief, Energy Division

Karen Pettigrew*
Assistant Attorney General

P.O. Box 12548, Capitol Station
Austin, Texas 78711-2548
(512) 463-2063

Attorneys for Appellee
*Counsel of Record

September 1, 1988

Questions Presented

1. Whether this Court has jurisdiction when the issues asserted by appellant were not presented and ruled on by the Texas courts.

2. Whether the calculation of federal income taxes to be charged in appellant's rate structure must be artificially inflated to protect the appellant from a taking without compensation.

3. Whether appellant can complain of a violation of due process when it presents evidence on a particular matter, but loses on a legal ground it had not considered.

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IN THE
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OCTOBER TERM, 1988

HOUSTON LIGHTING & POWER COMPANY,
Appellant,

vs.

PUBLIC UTILITY COMMISSION OF TEXAS,
Appellee.

ON APPEAL FROM THE
SUPREME COURT OF TEXAS

Motion to Dismiss or Affirm

Pursuant to Supreme Court Rule 16.01, the Appellee Public Utility Commission of Texas ("PUC") moves to dismiss or affirm the appeal filed on behalf of Houston Lighting & Power Company ("HL&P"). The motion is grounded on the fact that the appeal is not within this Court's jurisdiction because the federal questions sought to be reviewed, which went unaddressed by state courts, were not timely or properly raised and the fact that the appeal does not present substantial federal questions.

Jurisdiction

This Court lacks jurisdiction to hear this appeal under either 28 U.S.C. §1257(2) or 28 U.S.C. §1257(3) because HL&P failed to present the federal questions to, and have them passed on by, the Texas courts.

Statement of the Case

In the underlying rate case from which this appeal arises the Texas PUC was obliged to determine the appropriate regulatory treatment for HL&P's expenses in its cancelled Allens Creek Nuclear Plant ("ACNP"). The utility abandoned this plant in the planning stages, prior to receiving a license from the Nuclear Regulatory Commission. The utility expended almost $362 million and then decided not to construct the plant. As part of a larger rate case before the PUC, Docket 4540, HL&P initiated the regulatory inquiry into the treatment of ACNP expenses. As a result of HL&P's actions, the PUC was requested to decide whether HL&P should recover all of its ACNP expenses from ratepayers, as sought by the utility, or an alternative allocation of the costs between ratepayers and shareholders.

The PUC ultimately determined that ACNP, actually cancelled on August 26, 1982, should properly have been cancelled on January 1, 1980. In regulatory terms the PUC's decision meant that

expenses incurred prior to that date were prudent and permissibly recoverable from ratepayers, but expenses incurred after that date were deemed imprudent and were not available for recovery through its rate structure. The PUC thus determined to charge the ratepayers $195 million ($19.5 million a year over a ten year period) for ACNP. This amount is in addition to the Construction Work in Progress ("CWIP") previously charged to the ratepayers in prior PUC dockets. For all prior dockets and Docket 4540, CWIP for ACNP totalled $324 million. *See* HL&P Appendix at 118a. The PUC further determined that for ratemaking purposes, the one time tax write-off by HL&P of ACNP expenses would reduce HL&P's actual incurred tax costs by $111 million. The PUC accordingly reduced the federal income tax amount charged to ratepayers by the $111 million to preclude assessing the ratepayers for a tax the utility would never pay.

Following the decision of the PUC and as a prerequisite to any appeal to the state courts, HL&P filed a 57 page motion for rehearing with the agency. In that motion HL&P made thirteen generalized references to possible constitutional claims. See Appendix I, Excerpts from HL&P's Motion for Rehearing Before the PUC. None of the references was to federal constitutional impediments to the

challenged tax computation. Moreover, HL&P only made one reference to confiscation of its property under the United States Constitution, *see Id.* at B, but that reference concerned the entire rate order, not the particular tax calculation now complained of by the utility.

Three Texas courts (district court, appellate court, and supreme court), reviewed the rate order and did not pass on the constitutional questions now urged by HL&P in its Jurisdictional Statement to this Court. Only after the Texas Supreme Court issued its opinion did the utility frame the two federal questions it seeks to present here in the form of a motion for rehearing to that Court. *See* Jurisdictional Statement at 5. The Texas Supreme Court summarily overruled the motion.

Argument

1. This Court lacks jurisdiction to hear this appeal for HL&P failed to properly present the federal question of confiscation to the Texas courts for resolution.

HL&P's principal complaint to this Court is that the PUC's calculation of federal income taxes charged to the ratepayers as a result of its cancellation of ACNP is a taking of its property without compensation. HL&P did not raise or press

this issue before the Texas courts and denied the Texas courts the opportunity to pass on it. Therefore, under the holdings of this Court, this Court should refuse review of the decision below under 28 U.S.C. §1257(2) or 28 U.S.C. §1257(3).

This case is directly analogous to *Bankers Life and Casualty Co. v. Crenshaw*, ___ U.S. ___, 108 S.Ct. 1645 (1988). There, the appellant did not raise the appropriate federal question in its appeal to the Mississippi Supreme Court but merely urged a generalized constitutional argument in its motion for rehearing. *Id.* at 1649. This Court held that the federal question was not properly raised by appellant in the Mississippi Courts, thus denying the Mississippi Courts the opportunity to adjudicate the issues appellant later sought to have reviewed by the Supreme Court. *Id.* at 1650. In reaching this holding the Court relied on and quoted *Webb v. Webb*, 451 U.S. 493, 501 (1981):

> [a]t a minimum . . . there should be no doubt from the record that a claim under a *federal* statute or the *Federal* Constitution was presented in the state courts and that those courts were apprised of the nature and substance of the federal claim at the time and in the manner required by the state law.

Bankers Life and Casualty Co. v. Crenshaw, ___ U.S. at ___, 108 S.Ct. at 1650.

The need to properly present the federal questions is equally applicable, whether this Court's jurisdiction is sought under 28 U.S.C. §1257(2) or 28 U.S.C. §1257(3). *Id. Clark v. Jeter*, ___ U.S. ___, ___, 108 S.Ct. 1910, 1913 (1988). *See also Peralta v. Heights Medical Center, Inc.*, ___ U.S. ___, ___, 108 S.Ct. 896, 898 n.4 (1988). Additionally, this Court has repeatedly held

> that when, as here, the highest state court has failed to pass upon a federal question, it will be assumed that the omission was due to want of proper presentation in the state courts, unless the aggrieved party in this Court can affirmatively show the contrary.

Street v. New York, 394 U.S. 576, 582 (1969).

HL&P not only did not raise the federal question of taking without compensation with the Texas courts, but under Texas law the utility, through its own fault, could not have raised the question. HL&P's motion for rehearing before the PUC must have included specific reference to its federal confiscation claim urged before this Court to confer jurisdiction on the Texas courts to consider the claim. It did not. *See* Appendix I at B.

Texas law requires that upon issuance of a final agency order a party must file a motion for rehearing before the administrative agency and have such motion overruled as a jurisdictional prerequisite to review of the agency's order by Texas courts. TEX. REV. CIV. STAT. ANN. art. 6252-13a §§16(e), 19(e) (Supp. 1988) ("APTRA"); *Lindsay v. Sterling*, 690 S.W.2d 560, 563 (Tex. 1985). The motion for rehearing must not only be timely filed but also must specify the particular error of the agency complained about, e.g., finding of fact, conclusion of law, ruling or other action, and the legal basis for the claimed error. APTRA §16(e). *See Suburban Utility Corporation v. Public Utility Commission*, 652 S.W.2d 358, 365 (Tex. 1983).

Texas courts have repeatly held that the claimed error will be waived unless the motion for rehearing is ". . . sufficiently definite to apprise the [agency] of the error claimed and to allow the [agency] opportunity to correct the error or to prepare to defend it." *United Savings Association of Texas.v. Vandygriff*, 594 S.W.2d 163, 168 (Tex. Civ. App. - Austin 1980, writ ref'd n.r.e.).[1] A motion for rehearing

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1 The court further held:

> For the agency to be able to correct its errors, it must be on notice as to what the movant alleges constitutes error. Technical specificity is not required, it is true, but the agency should not

is not sufficiently specific to confer jurisdiction if the errors complained of are merely alleged in a generalized format. *Burke v. Central Education Agency*, 725 S.W.2d 393, 397 (Tex. App. - Austin 1987, writ ref'd n.r.e). ("To generalize . . . is to omit; and, to omit is to render doubtful what is intended to be included in such overly broad assignments of error.") *Snead v. Texas State Board of Medical Examiners*, No. 3-87-254-CV, Tex. App. - Austin, June 29, 1988 (not yet published).

HL&P could not, and did not, press the federal taking without compensation claim before the Texas courts. The Texas courts could not, and did not, pass on the claim. Accordingly, the federal claims now

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> be put in a position of having to guess what error is alleged. If any lesser degree of specificity had been intended by the legislature, we must presume that it would have provided for a mere 'notice of appeal' . . .

United Savings Association of Texas v. Vandygriff, 594 S.W.2d at 170. *See also Railroad Commission of Texas v. Bishop Petroleum, Inc.*, 736 S.W.2d 724, 744 (Tex. App. - Waco 1987), aff'd in part, rev'd and rem'd in part, per curiam, 751 S.W.2d 485 (Tex. 1988) (Court did not acquire jurisdiction to consider blanket allegations that an agency had violated every error listed in APTRA, Section 19(e) when the agency did not attack the blanket allegations in its plea to the jurisdiction.).

presented by HL&P were not properly raised below, and this Court is without jurisdiction to review them.[2]

2. This case presents no substantial federal questions.

This Court should refuse to hear this appeal as it presents no substantial federal issues. The PUC's decision in calculating federal income taxes charged to the ratepayers as a result of the cancellation of ACNP is but one of hundreds of decisions which constitute the final rates ordered in the case in Docket 4540. This Court has counselled that it will not review particular calculations by a regulatory body if the end result of the case as a whole is fair to utility ratepayers and shareholders alike. *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591 (1944).[3] Furthermore, since

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[2] The policy reasons behind the state requirement for a motion for rehearing to secure judicial review of an agency order and the courts' requirement that an issue be presented to and passed on by state courts prior to its review are the same. In both cases the entity first charged with inquiring into a particular question should be given the opportunity to develop the record and decide the question. *Webb v. Webb*, 451 U.S. at 500.

[3] The case is thus not similar to *Barasch v. Pennsylvania Public Utility Commission*, 516 Pa. 142, 532 A.2d 325 (1987), *prob. juris. noted sub. nom. Duquesne Light Co. v. Barasch*, 108 S.Ct. 1105 (1988). There the Pennsylvania Supreme Court held that a state statute precluded *any* recovery by the utility for expenses in a cancelled plant. Here the utility recovered -- and the ratepayers are obligated to pay -- $195 million of the $362 million spent for a plant that was never built and that never

regulatory bodies have already virtually completed the treatment of cancelled nuclear plants, *see* Edison Electric Institute, Rate Regulation Department, *Regulatory Treatment of Cancelled Plants: Survey and Analysis of Cases* at 5 (regulatory bodies in 34 jurisdictions heard 94 cases involving cancellation of nuclear power plants between 1977 and 1986), the need for guidance from this Court has come and gone, if it ever existed.

3. The PUC's decision charging ratepayers only for the utility's actually incurred taxes does not constitute a taking without compensation.

This Court has equated compliance with the just and reasonable standard for setting utility rates to compliance with the confiscation standard of the fifth amendment of the United States Constitution. *Federal Power Commission v. Natural Gas Pipeline Co.*, 315 U.S. 575, 586, 62 S.Ct. 736, 743 (1944). The Texas Public Utility Regulatory Act ("PURA"), TEX. REV. CIV. STAT. ANN. art. 1446c (Vernon Supp.

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generated electricity. This charge to ratepayers is in addition to CWIP previously allowed by the PUC for ACNP. Moreover, the regulatory body did not preclude the utility from utilizing the federal income tax write-off allowed by federal law. Unlike the Pennsylvania utilities, HL&P has not been denied recovery of expenses.

1988), specifically adopts this constitutional criteria for rates charged by a particular utility. PURA §§2, 38. Section 2 of PURA provides, in part:

> The purpose of this Act is to establish a comprehensive regulatory system which is adequate to the task of regulating public utilities . . ., to assure rates, operations, and services which are just and reasonable to the consumers and to the utilities.

One component of setting just and reasonable rates is the determination of operating expenses. In establishing appropriate criteria, section 39 of PURA provides:

> In fixing the rates of a public utility the regulatory authority shall fix its overall revenue at a level which will permit such utility to recover its operating expenses together with a reasonable return on its invested capital.

PURA, §39 (Supp. 1981). The Texas Supreme Court has determined that operating expenses must be allowed when such expenses are actually, reasonably and necessarily incurred. *Suburban Utility Corporation v. Public Utility Commission*, 652 S.W.2d at 363. Therefore, following its statutory mandate and applicable legal precedent, the PUC reviewed HL&P's treatment of federal income tax

expense and determined that as a result of the write-off of ACNP, the utility's taxes would be lowered. Had the PUC refused to take into account the impact of the ACNP tax write-off, the ratepayers would have been allocated a disproportionately high federal income tax expense, which expense would have been a hypothetical not actual expense as required by PURA.[4] The PUC's treatment of the tax expense item thus complied with its statutory and constitutional mandate to set just and reasonable rates.[5]

To support its claim of taking without compensation, HL&P asserts that disallowed expenses become nonutility property. HL&P Jurisdictional Statement at 13-16. HL&P is impliedly relying on an accounting methodology utilized by

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4 *Accord e.g., Barasch v. Pennsylvania Public Utility Commission*, 493 A.2d 653, 655 (Pa. 1985); *State ex. rel Allain v. Mississippi Public Service Commission*, 435 S.W.2d 608, 618 (Miss. 1983).

5 HL&P incorrectly cites *Brooks-Scanlon Co. v. Railroad Commission*, 251 U.S. 396 (1920), for the proposition that non-utility property cannot be used to subsidize utility rates. *Brooks-Scanlon* involved a company one of whose holdings was a rail line. The rail line was unprofitable and the company discontinued its use. The state regulatory body ordered the company to go back into business at rates below the cost of service on the line. This Court found "A carrier cannot be compelled to carry on even a branch of business at a loss, much less the whole business of carriage." *Id.* at 184, 399. The Court in effect ordered the regulatory body to recognize the utility's actual costs. The PUC did exactly that in the case on appeal here.

regulated industries and regulatory bodies for reporting purposes. The methodology provides that when expenses are disallowed, such expenses may be reclassified as nonutility "property." *See* Amicus Curiae Brief of Arthur Anderson & Co. at 3-5. HL&P then asserts that the tax effects of the reclassified property are likewise reclassified as nonutility "property." HL&P's reliance on a method of keeping accounts to label property for *all* regulatory purposes oversteps the bound of reason.[6]

First, while the accounting methodology relied on by HL&P is a mechanism for reporting information to the PUC and other regulatory bodies, the use of any particular mechanism for information reporting does not foreclose the PUC from fully examining the operations of the utility to set just and reasonable rates. *Re. Southwestern Electric Power Company*, 43 P.U.R. 417, 421 (Tex. P.U.C. 1981); *Cf. Thor Power Tool v. Commissioner of Internal Revenue*,

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6 *All* of the expenses related to a cancelled plant are not de facto utility expenses in the traditional sense. Such expenditures provide nothing that benefits the ratepayer; nothing is used and useful, nothing is dedicated to the public service. The treatment of cancelled plant expenses and how to balance the costs between ratepayers and shareholders cannot be construed in the same light as the standard inquiry into operating expenses or into adding plant costs to ratebase. The regulators must determine how to continue to encourage investment in new facilities and yet not penalize the ratepayer with an unreasonable cost for a power plant that is not and will not be functional.

439 U.S. 522, 532, 99 S.Ct. 773, 781 (1979) (authority of Internal Revenue Commissioner to disallow a particular accounting methodology if it did not accurately reflect the taxpayer's income).

Second, HL&P does not, and cannot, assert that the tax write-off of ACNP expenses was taken by the PUC from the taxpaying entity entitled to utilize the tax savings. Federal income tax law assesses taxes against corporations. 26 U.S.C. §11(a). Tax deductions, including the abandonment of investment such as the cancellation of ACNP, beneficially accrue to the corporation for purposes of determining its federal income tax expense. Shareholders are not individually billed for their portion of the corporation's federal income taxes, if any. Shareholders of a utility only have an income tax obligation to the extent that dividends are lower because ratepayers are not charged for the corporation's total taxes.[7]

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7 HL&P asserts that the PUC's calculation of taxes to be charged to ratepayers as a result of the ACNP cancellation is impermissible confiscation under this Court's decisions. HL&P incorrectly applies the cases relied on. In *Kaiser Aetna v. United States*, 444 U.S. 164 (1979), this Court, citing *Penn Central Transportation Co. v. City of New York*, 438 U.S. 104, 124 (1978), listed the economic impact of regulation, interference with investment based expectations, and the character of the government action as criteria to determine whether there has been an uncompensated taking. Here, the result of the calculation of federal taxes does not alter HL&P's ability to utilize the tax deduction when reporting to the Internal Revenue Service; investors in the company have benefited from the amount contributed by the ratepayer to the costs of ACNP; and

Third, the utility's argument rests solely on the proposition that the only constitutionally permissible methodology for calculating tax expenses for regulatory purposes is the methodology which ties the tax "benefits" to expenses as they have been classified for accounting purposes. To the contrary, the "actual taxes incurred" or "flow through methodology" used by the PUC in this case was found acceptable by this Court in *Federal Power Commission v. United Gas Pipeline Company*, 386 U.S. 237 (1967). Subsequent to this Court's holding in *United Gas Pipeline*, the federal agency regulating utilities determined to change its method of calculating taxes. That new method was challenged and the federal appeals court likewise found the alternative method acceptable. *City of Charlottesville v. Federal Energy Regulatory Commission*, 774 F.2d 1205, 1216 (D.C. Ct. 1985), cert denied, 106 S.Ct. 1575 (1986). In *City of Charlottesville* the court wrote: "Within certain rational limits . . ., which approach to choose [for calculating taxes] is more a matter of regulatory policy than of logic." *Id.* at 1221. Thus, when the PUC was faced with a choice between two methods of calculating income taxes for purposes of determining rates, and both proposed

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the PUC exercised its statutory and constitutional obligation to set just and reasonable rates when it made the tax calculation.

methods are permissible, the PUC was not bound by HL&P's preference.

For the above reasons, HL&P is incorrect in its position that the PUC has taken its property without compensation. Rather, the PUC has properly followed its constitutional and statutory mandate to set just and reasonable rates.

4. HL&P was not denied due process in the calculation of the federal income expense charged to ratepayers.

The utility, almost as an afterthought, urges this Court to review the decision below because of an alleged violation of the Fourteenth Amendment. Perhaps the issue is included because, although it failed here too, HL&P came closer to preserving it for review by Texas courts that it did with the taking issue. Nevertheless, HL&P did not properly preserve or press the federal due process question so as to avail the Texas courts an opportunity to pass on it. *See* generally discussion at pages 4-7 above.

Furthermore, HL&P is disingenuous in complaining of lack of notice of one particular part, the calculation of federal tax expense charged to ratepayers, of the ultimate treatment of expenses for the cancelled nuclear plant. The issue of the regulatory treatment of the cancellation of ACNP was initiated by HL&P at the PUC. HL&P Appendix at

116a. The utility recognized that there were federal income tax issues resulting from the cancellation of the plant. *Id.* The cancellation of ACNP was addressed extensively during the administrative proceeding. *Id.* at 113a-139a. Furthermore, the administrative record specifically includes HL&P's challenge to the actual dollar amount of the tax computation and additional explanation by the agency staff to the PUC Commissioners of that calculation. HL&P's federal due process rights are not violated whenever it presents evidence on a matter, but loses on a legal ground it had not considered.

Conclusion

The Court should dismiss or affirm the decision of the Texas Supreme Court because the federal questions were not properly raised and passed on by Texas courts and because this appeal does not present a substantial federal question.

Respectfully submitted,

JIM MATTOX
Attorney General of Texas

MARY F. KELLER
First Assistant Attorney General

LARRY LAURENT
Assistant Attorney General
Chief, Energy Division

KAREN PETTIGREW*
Assistant Attorney General

P.O. Box 12548, Capitol Station
Austin, Texas 78711-2548
(512) 463-2003
Attorneys for Appellee

September 1, 1988

**Counsel of Record*

Excerpts from HL&P's Motion for Rehearing Before the PUC

A. At page 2:

> "In view of this incomplete record, the Commission's addition of a finding of mismanagement is not supported by substantial evidence, is arbitrary and capricious, deprives HL&P of due process and threatens the interests of the other project Participants, who were not afforded a right to be heard."

B. At page 5:

> "The Commission's Final Order fails to conform to the standards established by the Public Utility Regulatory Act . . . and the Administrative Procedure and Texas Register Act . . . Unless the Commission undertakes to correct the errors contained in the Final Order, and the Examiner's Report adopted therein . . . HL&P will have been denied its rights to due process of law and will suffer confiscation of its property in contravention of the guarantees of the Constitutions of the United States and the State of Texas."

C. At page 7:

> "The Commission's findings on STP (South Texas Project) are not supported by the record, are arbitrary, capricious and beyond the Commission's legal authority. The

findings deprive HL&P of both substantive and procedural due process."

D. At page 13:

"This Commission has made sweeping, all encompassing findings with reference to HL&P's management of STP without giving HL&P an opportunity to be heard. This procedure violates the fundamentals of due process . . . HL&P had a right to clear notice that it was expected to make a full case on STP and that sweeping findings as to STP were contemplated in this docket."

E. At page 14:

"A deprivation of due process (i.e. a procedure by which significant findings are made without giving a party an adequate opportunity to be heard) is, of course inherently unlawful and basically bad; however there are concrete practical detriments which are imposed upon HL&P's ratepayers by the Commission's unsupported findings."

F. At page 16:

"The findings of administrative bodies, such as the Commission . . . normally, are the result of a deliberate hearing process in which all interested parties have presented all the relevant evidence and had an opportunity to

cross-examine adverse witnesses. As noted above, however, the Commission's findings concerning STP are not the result of such a process because neither HL&P nor the staff presented affirmative, complete evidence as to STP."

G. At page 19:

"The verbal thrashing which the Commission has imposed upon HL&P relating to STP is thus not only unsupported by the record, a violation of due process, affirmatively harmful to the consumers of electric power, it is *totally gratuitous.*" (emphasis in original).

H. At page 19-20:

"Advisory rulings as to the treatment of lawsuit results without regard to the findings in the suit and the evidence which will ultimately be adduced in the suit and in the management review contemplated by the procedure established in Docket No. 3320 is inconsistent as well as being an unlawful denial of due process."

I. At page 31:

"None of the circumstances cited as a basis for Finding of Fact No. 21 was a factor known only to HL&P . . . all such circumstances were known and acknowledged by the Commission . . . Yet the Commission itself never

suggested cancellation of Allens Creek. For the Commission to now determine it was imprudent not to cancel the plant by January 1, 1980 is not only arbitrary and capricious but in violation of constitutional and statutory provisions."

J. At page 35: HL&P claims that the PUC engaged in improper rate-making in adopting a treatment of benefits in a way which required HL&P to bear the burden of a disallowance of $166 million of the Allens Creek expenditures, but which did not allow HL&P to retain any tax benefits arising from those expenses:

> "It is not lawful under the Utility Act or the Texas Constitution to, on the one hand, preclude recovery through rates of expenses on the grounds of imprudence and, at the same time, use those same expenses for determining the regulatory allowance for income taxes."

K. At page 39:

> "The Commission erred in reducing the cost of equity by .5% to 16.35% (Revenue Ruling Modification B; Finding of Fact No. 10) for the following reasons:
>
> (a) Such action is in violation of HL&P's constitutional rights in that it results in a taking of HL&P's property without just compensation."

L. At page 43 HL&P states that the Commission erred in finding that HL&P mismanaged STP:

> "Such finding was made in violation of HL&P's rights to due process under the United States and Texas Constitutions as a result of the failure of the Commission to give notice that HL&P's management practices at STP were to be an issue in this proceeding."

M. At page 51:

> "The Commission erred in finding that the tax savings associated with the expenditures for Allens Creek disallowed by the Commission should be flowed through to the rate payers for the following reasons:
>
> (a) Such finding violates HL&P's right of due process in that such conclusion was reached without notice and fair opportunity to comment."